THE RELATION OF PUBLIC FINANCE TO PRIVATE CREDIT[1]

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The economist or the student of finance, in discussing the theory of credits, must necessarily analyze the interaction of gold reserves, of inflation and depreciation, and the effect of favorable or adverse balances of trade. Deferring to your superior knowledge of these most interesting and important matters, I shall not attempt to deal therewith. I shall, if I may, ask you to approach the general subject from a somewhat different angle, and to regard private credit as the national basis upon which any constructive international commercial and financial development must depend.

In the past, we in the United States unfortunately have been accustomed too generally to consider credit problems not on their intrinsic merits but from partisan points of view. Thanks to our enormous resources, we have been able to borrow freely, and on easy terms, from Europe. Our own capital, therefore, inevitably has been attracted by quick returns, and we have been influenced by reasons of immediate expediency rather than guided by a clear conception of the ultimate goal. In consequence, we were long blind to the necessity of evolving a well-balanced, consistent, and progressive national financial policy, designed to correlate and galvanize into effective coöperation the agricultural, industrial, and commercial activities from whose cumulative power such a policy should derive its momentum. Our failure to appreciate the importance of creating adequate credit machinery cost us dearly. We persistently disregarded the bitter experience of recurring panics, and were long deaf to the recommendations of men who, like the late Senator Aldrich and Mr. Paul Warburg, urged the organization of a banking system which would enable us to mobilize our reserves and to utilize to the fullest extent our credit resources.

In the twenty years preceding our Civil War, the United States had traded in every sea. Foreign commerce in those days was largely a question of barter. The intricate problems of international finance, which are now so absorbing, were unheard of, and the development of markets by judicious investment was

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virtually unknown. Great Britain, Germany, and France later discovered that bankers held the golden key to overseas trade. We, however, were busily engaged in borrowing abroad and ourselves had no surplus funds for foreign investment. We exported raw materials and imported manufactured goods. Following the Spanish War, however, American industry, through the great combinations, became organized in units sufficiently powerful to enable it to enter the export trade. Our manufacturers soon realized that unless American bankers would finance their foreign customers, they could not compete with British and German industry. An American banking group was organized for China, and loans to South and Central American republics were considered. A certain stage of what might be termed economic saturation having been reached within our own boundaries, we began to look abroad. Just as the development of our eastern seaboard enabled the merchants of the early fifties to hold their own in the trading competition of the period, so the general standard throughout our country just prior to the European War had brought our bankers and manufacturers to the point where increasing production and accumulating capital at home, and the ability to borrow on low terms in London and Paris, made them anxious to enter the financial-commercial struggle for trade with the as yet undeveloped corners of the earth. The Federal Reserve Act, by releasing reserves, added tremendously to our credit resources and promised to give a fresh impetus to our desire for trade expansion. Before the efficacy of this new machinery could be tested, however, it was subjected to the sudden strain of war.

The American republics were differently affected by this world-wide crisis. We, who have been able to sell largely to Europe, have been enriched. The countries which have depended upon European capital for their development have been obliged to postpone many important works. But all of us shall be wise indeed if, by closely observing the manner in which the nations now at war deal with the problems to which this crisis has given rise, we are able to profit by their example and to avoid the consequences of their mistakes.

At the outset, Germany alone was prepared. Not only her armies, but her financial and industrial resources, were at once mobilized. In France and in Great Britain, the magnitude of the task and the necessity for correlating every form of national activity in the supreme struggle for victory was not at once realized.

But coincident with military and naval endeavor, the importance of conserving national credit was recognized from the outset. The German problem of war finance has been simplified by Germany's inability to import goods from abroad. The question of at present providing gold exchange has consequently been one of subordinate importance. Great Britain and France, on the other hand, have been obliged to purchase vast quantities of material, and their financial measures will repay the most careful study. Early steps were taken by these two governments to assure the continuance of business as nearly as possible along normal lines. In England, bill brokers and foreign exchange houses, as well as manufacturers and merchants engaged in overseas trade, were given special guarantees by the government. Proceeds of the war loans were utilized in a manner calculated to assure uninterrupted and profitable business, in order that the proceeds thereof might be subject to yet further calls. When the London Stock Exchange was opened early in the present year, it was announced that no new foreign issues might be made without the permission of the Chancellor of the Exchequer. The financial resources of Great Britain were to be conserved for the prosecution of the war. Pressure was brought to bear upon British investors to induce them to sell their holdings of American securities in order that they might invest in the British war loans. Only recently the government has taken steps to mobilize American obligations held in Great Britain, to be utilized under government direction to maintain exchange between London and New York. In France, through the coöperation of some of the large private banking houses, French investors were induced to deposit their holdings of American issues to provide the basis for a credit which was negotiated in this country. In both England and France, every effort was made to issue war loans in a form which would attract the small investor. In other words, European financial policies have been calculated to insure the national organization of credit to provide means for continuing the war not only by financing military operations, but by granting extraordinary facilities to conserve financial, industrial, and commercial resources to the fullest extent possible. Such synchronization of effort—coöperation on such a scale—is without precedent. For us in the United States at least, it would, in the absence of special legislation, be impossible. Yet we too have widened our financial outlook and engaged in operations which two years ago we should have considered fantastic. In the autumn of 1914, our

most pressing problem, the stabilization of exchange by the settlement of our immediate debt to Europe, required the united energy of the newly organized Federal Reserve Board and the bankers who loyally stepped into the breach. Within six months after the commencement of hostilities, however, we were busily engaged in this country in devising ways and means by which we might assist Europe to pay for our goods which were being purchased in increasing volume. We bought back from Europe great quantities of our securities. A series of minor credit operations culminated in the flotation of the great Allied loan. The success of the war loans in Great Britain, France, and Germany depended upon the credit of the countless private individuals who subscribed their savings to support mobilized and correlated military, financial, industrial, and commercial activities. In making a public offering of the Anglo-French loan in this country, the American bankers were performing a function analogous to that of the governments in Europe. By mobilizing our private capital, they were endeavoring to create a public credit to finance the great export trade from which our present prosperity has been derived. This transaction was almost as important to this country as a whole as it was to the powers now at war. Every individual who has invested in the European credits which have been negotiated here has stimulated American industry by facilitating the export of American goods and, by acquiring a private investment, has performed a public service.

Prior to the outbreak of the war in Europe, there had been intimate commercial relations between the American nations. The trade between this country and our sister republics farther to the south, however, had not been developed. There was a long established British and French investment in the Argentine, in Brazil, in Uruguay, in Chile, and Peru, and the dealing between South and North America were largely conducted through London and Paris. The relationship was triangular—imports into the United States from South America were heavily in excess of our exports—and our debit balance was settled in pounds sterling. The declaration of moratoria, the dislocation of credit machinery, the interruption of shipping, affected the entire American continent. Canada only was at war. The neutral nations, finding the old channels of trade suddenly blocked, looked to each other. We set to work to examine our mutual needs, and endeavored to find means by which we might be of mutual assistance. Steps were taken to

handle exchange direct between New York and the other American financial centers. Branches of the National City Bank were opened to provide facilities which had not theretofore existed. Informal discussions between diplomats and representatives of American business developed into the Pan-American Financial Conference held last spring under the auspices of our Secretary of the Treasury. Pan-Americanism, which too long had been a pleasant after-dinner phrase, gradually assumed practical significance, as it was realized more generally throughout both continents that an increasing intimacy would be mutually beneficial.

It is difficult to generalize. Each nation has problems peculiarly its own, which must be given separate consideration and regarded in the light of particular needs. It is, nevertheless, possible to state that, in almost every case, the republics to the south require capital for their development, while the United States is seeking more extensive markets for its manufactured goods.

By reason of our present great and increasing prosperity, and the restrictions which the necessity for reconstruction will impose upon the European bankers who have hitherto financed development enterprises throughout the world, it would seem inevitable that those who are seeking capital must, for a time at least, largely depend upon the accommodation which they may be able to secure in this country. Fortunately, with the increase of our investing power, there has come a rapidly growing appreciation of the fact that this power, constituting as it does a national asset, should be utilized for national ends. The resources which we shall have at our command will undoubtedly in some measure be available for the rehabilitation of European industry after the war. It will be to our selfish interest to assist in so far as we consistently can in the restoration of normal financial and commercial conditions throughout the world. In order that American industry, upon which our prosperity so largely depends, may benefit by the use of our lending power, however, it must be a primary feature of our policy, as far as possible, to utilize our available capital in co-operation with the borrowers to create and assure a market for American goods. But the readiness of American bankers to undertake to offer foreign securities will necessarily depend upon the credit of the prospective borrower, and upon the return to be derived from the purchase of the securities offered. The credit of certain of our sister republics in South and Central America is unquestioned, but the development of others, equally rich in re-

sources, has in the past been hampered by political disturbance. They have afforded fields for speculation, rather than for investment, and foreign capital has too frequently allied itself with one political party or another for illicit mutual gain, rather than to secure a legitimate profit for public work well done. It has often been urged that our own government should in some way guarantee or assure the safety of foreign investments undertaken by its nationals. Our State Department may use its good offices to secure the enforcement of a just contract entered into in good faith, but it cannot, and should not, act as a collecting agency. It is in the interest of those who desire to borrow, nations as well as individuals, to maintain their credit in order that they may secure necessary financial assistance on reasonable terms. To assure public is to safeguard private credit. Where private credit is unquestioned, national borrowing power is secure.

The European War has given to the American republics a new bond of mutual dependence. Politically we are closer than ever before. In our mutual necessity, there is a need, and at the same time an opportunity, for much more intimate commercial and financial coöperation. You require capital, while we in turn must try to stimulate the exchange of products between this country and our sister republics to the south. In order that we may sell our goods to you, we must enable you to produce more which we in turn can purchase. We are beginning to realize that we must furnish capital to our customers if we would market our goods. We must maintain a relationship which, in being mutually profitable, will bring a better mutual understanding of our aspirations and ideals. Such a relationship can be established if those who would secure financial assistance offer conditions which will attract our investment, and if we in turn are willing to grant the credits which will enable you to purchase in this country the articles which you require. Both lender and borrower must mobilize private credit—the borrower in order that he may borrow advantageously for the development of his resources, the lender in order that he may lend intelligently for the extension of his national trade. Private credit is the ultimate basis of international finance, and we are just entering upon an era where public finance will play an increasingly important part as the most powerful instrument of constructive domestic, as well as foreign, national policy.